The M2M Optional Underwriting Model (Version 3.2, dated 10-10)
Fine Points and Suggestions For Use

1. StartInput Page:

- C24 (Year Constructed) controls the 'approximate age of property' cells in PCAInput.
- J10 and J11 (Post-Restructure mix of assisted and non-assisted units) drive the per-unit calculations in ProjectedInc&Exp.
- H50 (Appraised value) is used in evaluating Loan to Value (LTV) constraints on sizing the new 1st mortgage, on the DS&LoanSizing page. For example, §223(a)(7) loans may not exceed 100% LTV.
- G33-G40 (number of §8 assisted units): If the property is <u>not</u> 100% §8, in determining the market rents the PAE should closely evaluate the owner's actual experience in pricing and leasing the non-assisted units, as these units may provide excellent information on the property's market rents. Comments on the non-assisted units can be included in the 'General and Market Comments' box (rows 52-60).
- The revision number and date are located in cells J2 and J3.

2. LoanInput Page:

- Important Primary Loan information that is used elsewhere in the model:
  - D14 (Annual Debt Service) feeds the HistoricInc&Exp and ProjectedInc&Exp pages.
  - D6, D7, D10, D12 (UPB As Of Date, UPB Amount, Rate, Monthly P&I Payment) feed the amortization schedule (lines 76+)
  - D19 (Remaining Term). For insured loans, Remaining Term as of the M2M closing date (plus 12 years) is maximum §223(a)(7) loan term
- D58-D60 (UPB For Loans To Be Restructured):
  - This feeds the Sources and Uses (and PPC) calculations
  - D57 ('As Of Date' for M2M closing) should be the date on which you expect the restructuring to close.
  - The UPBs, for the loans to be restructured, should be as of the closing date.
- Lines 76-116 (Amortization Table) is provided to assist the PAE in projecting the UPB of each loan that will be restructured, as of the estimated M2M closing date. The shaded boxes are pre-loaded to pull the relevant first mortgage data but may be modified by the PAE to obtain amortization data for other loans to be restructured.
- For Section 236 loans:
  - D10 (Interest Rate) should be the note rate (generally 7.0% - 8.5%)
  - D13 (Mortgage Insurance Premium) should be included if the lender actually receives MIP (generally, the Interest Reduction Payment covers MIP, plus the difference in P&I payment between 1% / 40 years and note rate / 40 years).
  - On the Historic Income and Expense page, be sure to enter the Interest Reduction Payment as a negative amount.
  - If the Restructuring Plan will utilize recaptured Interest Reduction Payments, use the IRP&Recapture Page (see Addendum at the end of this document).

3. RentInput Page:

- Q11-Q18 (Current assisted rents). Enter these amounts.
- Utility Allowance:
  - F30-F37 (Current Utility Allowances). These can be found on the most recently approved HUD-92458 Rental Schedule.
  - F48-F55 (Proposed Utility Allowances). Normally, the same as the current U/As.

- So long as these utility allowances are appropriate for the non-assisted units as well, no other Utility Allowance input is necessary.
- Cells F30-F37 feed post-M2M utility allowances (F48-F55 and Q48-Q55), the utility allowances for the AMI calculation (D11-D18), and the current non-assisted utility allowances (Q30-Q37). However, each of these sets of utility allowances can be modified if appropriate.

➢ For the AMI and FMR Calculation, enter the following:
- G11-G15 (Current FMRs)
- J7 (FMR area)
- E23 (FMR fiscal year)
- N13 (4 person very low income limit)
- N21 (4 person median income)
- J6 (AMI area)
- E22 (AMI fiscal year).
- See http://www.huduser.org/datasets/il/fmr99/index.html for set-aside figures and FMRs.

➢ For Proposed Rents, enter the following:
- U11-U18 (PAE's market rent conclusions). These cells drive the proposed assisted rents (E48-E55).
- Q11-Q18 (Current Contract Rents). These cells drive the current assisted rents (E30-E37).
- R11-R18 (owner's market study rents), if applicable.
- T11-T18 (PAE's appraisal rents)
- S11-S18 (PAE's market study rents), if the PAE obtained a market study in addition to the required limited scope appraisal

➢ Non-revenue units (units converted for use as office, model, storage, service centers, etc.):
- Verify whether the non-revenue units are currently included in Gross Potential or not (pre-M2M), and make sure the unit counts on this page correctly reflect the total units in Gross Potential.
- If the Restructuring Plan proposes to convert non-revenue units to revenue-producing status, be sure the post-restructuring unit counts are correct.

➢ If the Restructuring Plan will change the property's unit count, be sure that the post-restructuring unit counts (cells D48-D55 and O48-O55) are correct. Include appropriate comments in rows 81-85.

➢ Special considerations for properties with non-assisted units (pre-M2M):
- O30-O37 (Number of currently non-assisted units). Enter the correct unit counts. Be sure this agrees with the Start Input page (cell I11).
- P30-P37 (Current non-assisted rents). These cells are pre-loaded to pull the assisted rents. If there are non-assisted units with current rents that differ from the assisted rents, be sure to over-write the pre-loaded amounts.
- Q30-Q37 (Current non-assisted utility allowances). If the non-assisted U/As differ from those for the assisted units, enter the correct amounts.
- Include appropriate comments in rows 81-85.

➢ Special considerations for properties with units that will be non-assisted after M2M:
- Reflect the appropriate number of units in cells O48-O55.
- If the post-M2M non-assisted rents will not be at market, be sure to reflect the appropriate rents in cells P48-P55.
- Be sure that cells Q48-Q55 reflect the correct utility allowances for the non-assisted units.
- Include appropriate comments in rows 81-85.

4. Historic Income and Expense Page:

➢ H7-H11 (Trending rates): these are used to trend your Typical Historical conclusions to produce the Typical Historical Trended figures. Accordingly, they should reflect the appropriate trending rates to bring historical expenses forward to the estimated M2M closing date.

➢ M7 (# months YTD actuals): if you have unaudited actuals for the current year, enter the number of months included in your actuals (example: actuals through August = 8).

➢ M8 (Begin Trending date): enter the date of your Typical Historical conclusion. For example, if your Typical Historical conclusions are 1999 numbers, enter 1/1/99. If year 2000, ensure correct entry of the year. Some older versions of Excel will read a "00" year entry as 1900 instead of 2000.

- Columns E, F and G (Audited actuals). Enter all three years.
  - Do not modify these figures. Reflect them exactly as shown in the audits.
  - Reflect the correct initial year in cell H12.
  - Be sure to reflect actual Reserve deposits (row 117), MIP (row 123), and (for Section 236 properties) Interest Reduction Payments (row 124). IRP, if applicable, should be entered as a negative amount.
- Column H (Current year unaudited operating results). Enter these, if available (be sure to reflect the correct number of months in cell M7).
- Column K (Typical Historical conclusions):
  - Should reflect continuation of the status quo (project based §8, current management approach, current staffing, …).
  - These are not the average of the historical expenses.
  - Eliminate non-recurring expenses (for example, water leaks, one time income items, unusual legal costs).
  - Eliminate capital items from the maintenance expenses. Focus on Repairs Material, Repairs Contract, HVA C Repairs, Grounds, and Elevator.
  - Be sure to reflect actual Reserve deposits (row 117), MIP (row 123), and (for Section 236 properties) Interest Reduction Payments (row 124). IRP, if applicable, should be entered as a negative amount.

5. Projected Income and Expense Page:

- Column E (Appraisal amounts). Enter these, if applicable and helpful.
- Column G (Other benchmarks). If using other operating expense benchmarks such as industry averages, or data from comparable properties, enter it here.
- E11 and E12 (Property management fees):
  - Determine the dollar amount a competent third party agent would bid.
  - The model converts those dollar amounts to percentages.
- J9 and J10 (Apartment vacancy rates):
  - Must be at least 5%.
  - If market vacancy rates are higher than 5%, reflect the market vacancy rate in (at least) the M2M tenant based column.
- N9 and N10 (Apartment bad debt rates). Must be at least 2%.
- Column K ('M2M Project Based'). Enter your conclusions. When underwriting expenses, PAEs should consider at least the following questions:
  - Will the staffing pattern change after M2M?
  - Will the number of non-revenue units change after M2M?
    - The answer may affect the appropriate vacancy allowance.
    - Any units reflected as 'Mgmt or Super Free Rent Unit' must also be included in the Gross Potential Rent.
- Will utility costs change (for example, due to energy efficiency expenditures, or due to replacing inefficient older appliances or HVAC systems)?
- Will the level of maintenance change? Under-maintained properties will shift to standard maintenance. So will over-maintained properties.
- Will real estate taxes change?
  - Some localities assess properties based on the property's actual NOI, which will decrease after M2M.
  - If the property has a tax abatement or PILOT, determine whether it will continue after M2M.
- Does the property require a different level of security / protection costs?
- Should an existing Neighborhood Network be continued? Should a proposed Neighborhood Network (approved by the MF Hub / PC) be implemented?
- Does the property require a different level / mix of non-housing services?
- Determine 'M2M Tenant Based' expenses. The following line items are particularly likely to vary from the M2M Project Based scenario:
  - Marketing.
  - Property Management Fee.

- Staffing.
- Maintenance expenses related to resident turnover (turnover rate may be higher if tenant based).
- Security / Protection.
- Non-Housing Services.

- K128 and M128 (MIP expense). The model calculates this as the appropriate MIP rate (from Loan Input D13) times the UPB as of the M2M closing date (from Loan Input D58). If there are multiple insured loans, enter the correct figure (reflecting the UPB of all insured loans). If the pre-M2M loan is HUD Held, there will be a "service fee" at the same percentage as the MIP (0.50%).
- K134 and M134 (DSCR). These cells show the property's DSCR, at market rents, versus the existing debt service. This figure shows how close the property may be to working as an OMHAR-Lite.

6. PCAInput Page:

- Enter constants:
  - D5 (First Year of Pro Forma) should be the 1st year after M2M.
  - H5 (OCAF) should be the average OCAF that you expect in the future. This may be different than the current year OCAF for your state.
  - D6 (Capital needs inflation rate) should be same as OCAF; otherwise, the later years of the 20-year schedule will be misleading.
  - H6 (Reserve interest rate) should be a market interest rate that you expect the owner to achieve when investing the Reserve funds. This rate should be a net rate, after accounting for the investment fees that mortgagees charge.
- Lines 12-51 (PCA results). Enter the results of the PCA, as adjusted by the PAE.
  - Line item costs should not include inflation. The model adds inflation to the total.
- Column E (Rehabilitation Escrow) versus Column F (Year 1):
  - Market upgrades go in the Rehab Escrow.
  - Items that were broken at the time of the PCA go in the Rehab Escrow.
  - Items that are projected to wear out in year 1 go in year 1.
- Review the Line Items (refer to the PCA checklist). In particular:
  - Items with EUL less than 20 years should show re-replacements. For example, carpets are shown as a 7-year EUL; carpets replaced in year 2 should be re-replaced in years 9 and 16.
  - The timing of replacements should reflect the actual condition of the existing components. Equal numbers of replacements in each year are unlikely to be accurate.
- Enter the fund balances anticipated as of the M2M closing date:
  - E60 (current Replacement Reserve balance). In the comment box, indicate the 'as of' date, and the source of the Reserve balance information.
  - E61 (anticipated deposits). Enter deposits expected to occur between the 'as of' date for cell E60, and the M2M closing date.
  - E62 (anticipated withdrawal). Enter withdrawals expected to occur between the 'as of' date for cell E60, and the M2M closing date.
  - E96 (Residual Receipts). Enter the amount expected to be in the Residual Receipts account as of the M2M closing date.
- E69 (Reserve Balance Floor). Should equal one year's Reserve deposits, at the amount being deposited when the asset was assigned to the PAE.
- Sizing the Rehabilitation Escrow:
  - F101 (Contingency). This is an amount, in addition to the estimated repair costs, as needed to give reasonable assurance that the escrow funds will be adequate to complete the appropriate repairs. OMHAR generally requires a 10% or larger contingency.
  - E102 Escrow Amount. Pre-loaded as the sum of estimated repair costs plus contingency. If additional amounts need to be included, this amount can be over-written by the user.
- Determine the appropriate IDRR (E64) and First Year deposits (E68):
  - First, set the IDRR equal to the floor, rounded up to the next $5,000. Set the first year deposit equal to the average annual capital needs (uninflated, cell E72).
  - If the Reserve balance is too low in the early years, consider increasing the IDRR.

- If the Reserve balance is too low in the later years, consider increasing the first year deposit.
- Fine-tune the IDRR and first year deposit so that they result in adequate funding for the 20-year cycle.
- When proposing large IDRR / small first year deposit combinations, satisfy yourself that the project will not run out of Reserves in years 20-30.
- When proposing small IDRR / large first year deposit combinations, satisfy yourself that the Reserve balance will not be too large at year 20.

➢ If there are surplus Reserves, the owner may be awarded up to 10% of the surplus (cell F98).

7. GPRCompare Page (Determine The Correct Adjusted NOI Scenario):

➢ Enter the RAAP results in cells H15 and H16.
- If tenant based, enter 4 in both cells H18 and H21, unless scenario 4 has negative ANOI (in which case you need exception rents, see below).
- If project based (or if no RAAP was required):
  - If scenario 2 has negative ANOI, you need exception rents, see below.
  - Otherwise, cell H18 is generally 2. Cell H21 is 3.

➢ If you need exception rents:
- Enter 5 in both cells H18 and H21.
- Go to Sizing Exception Rents (Addendum, below).

➢ Column N (User Defined). This is provided in case PAEs want to see how the project would perform under customized scenarios (for example, with rents that are 10% higher than market). If you want to see how the 1st Loan Pro Forma (column Q) would turn out under your customized scenario, enter 6 in cell H18. If you want to see how the 2nd Loan Pro Forma page would turn out, enter 6 in cell H21.

8. 2nd Loan ProForma Page:

➢ L5 (2nd Mortgage Split Percentage) will be 75% unless the PAE determines that the owner's return would otherwise be too large, and/or if the transaction is more viable at a higher percentage.

➢ G5 and G6 (Income and Expense Inflation Rates):
- OMHAR strongly suggests these be equal (else, the ANOI in future years may accelerate too fast, or may actually decrease).
- OMHAR recommends the likely future OCAF (G4, pulled from the PCA Input page cell H5) as a good starting point.

9. Sources&Uses Page:

➢ K4 (Owner's Share of Transaction Costs). This is the percentage that the owner will typically bear (generally 20%).

➢ J19-K38 (Transaction Costs). Enter the total expected transaction costs. The model calculates the owner's share. Modify any owner's-share amounts (if any) that are not in accordance with the Restructuring Plan.

➢ Column G (Misc. Sources and Uses). Enter any miscellaneous sources and uses.

10. DS&LoanSizing Page (Size the 1st Mortgage):

➢ Enter the financing approach (cell E5). This affects the structure of the sources and uses statement. It also affects the PPC calculation.

➢ F34 (New 1st Mortgage LTV limitation). Enter the limitation that is applicable to this loan program. For example, §223(a)(7) is limited to 100% LTV, §223(f) is limited to 85% LTV, §221(d)(4) is limited to 90% LTV. This will be used when comparing the new 1st principal to the appraised value entered in StartInput cell H50. A flag will appear if the LTV limitation is exceeded.

- Modify the User Defined Annual Debt Service for Sizing, if necessary. The model will default this cell to equal the debt service as calculated plus any IRP that will be applied to the new 1st debt service (as entered in the IRP&Recapture page cell D25).
- F25-F30 (New 1st Mortgage Business Terms). Enter the appropriate interest rate, term and MIP for the first mortgage.
- F20 (New 1st mortgage DSCR):
  - The initial (trial) level of DSCR should be 1.20, or a higher DSCR that is appropriate for a weak property and/or weak market.
  - The owner return (see 2ndLoanProForma page) should be adequate, but not excessive, in relation to the owner's capital requirement (cell K3). Refer to cells K5-K12 for further owner return summary.
- Test to see if exception rents are needed:
  - On the Sources&Uses page, does G24 have a positive amount? If so, the sources and uses do not balance.
  - Using exception rents that are large enough to support a 1st mortgage that is sufficient to balance the sources and uses can correct this.
    - On the GPRCompare page, enter 5 in both cells H18 and H21.
    - On the ExcptRent page, increase the amount in cell D17 by the 'out of balance' amount from the Sources and Uses.
    - Size the exception rents (see Addendum, below).

11. EquityReturn Page:

- After entering the 1st mortgage terms (DS&L page) and transaction costs (Sources and Uses page), enter the term and rates for the Capital Recovery Payment (CRP).
  - Enter the Amortization Period for the CRP in E6. This is generally 7 years.
  - Enter the Interest Rate in cell E7. Select the rate of a treasury with a similar term as that entered in E6, rounded to the nearest 0.25%.
  - Select a spread of up to 350 bps in cell E8.
- The model will calculate the CRP for all years in row 13. Hard code the year one CRP (PAE Determined CRP) in cell D14, making it equal to the CRP appearing in cell D13. Do not enter cell D14 as a formula reference to D13 or you may cause circular errors in the model. You may enter the remaining years of CRP as formula references to D14.
  - If you included Origination and/or Financing Fees as Transaction Costs, calculated as a percentage of the 1st mortgage amount, you may need to repeat the preceding step once or twice before your actual CRP (D14) equals the calculated CRP (D13).
- Enter the Incentive Performance Fee rate in cell F23. This is generally 3% of EGI, however:
  - If 3.00% falls below the $100 per unit floor, increase the percentage until the floor is reached.
  - If 3.00% falls above the $200 per unit ceiling, decrease the percentage until the ceiling is reached.
- The model will calculate the annual IPF in rows 27, 31, and 35. The PAE Determined IPFs in rows 28, 32, and 36 are pre-loaded to reference the calculated IPF cells for the duration of the new 2nd/3rd amortization period. However, rows 28, 32 and 36 may be modified by the PAE if necessary.

12. DS&LoanSizing Page (Size the 2nd Mortgage):

- L34 (Calculated Residual Value) and L35 (PAE Determined Residual Value). This is the likely market value of the property as of the maturity date of the new 1st mortgage.
  - If the property requires exception rents, and the conditions that cause the property not to be viable at market rents are projected to continue, the PAE may decide to set the PAE-determined residual value at zero (L35).
  - If the PAE wishes to use the income capitalization method to determine this value, enter the appropriate capitalization rate in cell L33.

- The PAE may use any reasonable valuation method, to arrive at the residual value. The Restructuring Plan must discuss how the PAE arrived at the residual value.
- Enter the PAE-determined residual value in cell L35.

- L41 (PAE Reasonable Expected Repayable Amount). This is the maximum amount of M2M subordinate debt that could be reasonably repaid.
  - This amount is independent of the actual PPC and the actual write-down. It is, in effect, the maximum amount that could be reasonably repaid, if the PPC and write-down were $100 million. This distinction is important, because owners, and potentially the IRS, will be interested in whether the 3rd mortgage is reasonably repayable, or whether a larger 2nd mortgage would have been reasonably repayable.

13. DS&LoanSizing Page (Size the 3rd Mortgage):

- Cell L51. Enter the PAE-recommended 3rd mortgage amount.
  - This may not be more than cell L50.
  - It must generally be at least 70% of cell L50 for for-profit owners and may be as low as 0% of cell L50 for non-profit owners. OMHAR recommends that PAEs reflect a reduced amount in L50 only to the extent necessary to make the transaction feasible.

14. Revisit The Sources&Uses Page

- Check the transaction costs again, in relation to the final 1st mortgage amount.
- Make sure the sources and uses still balance (zero amount in cell G24).
  - If not, you may need exception rents.
- Enter the appropriate discount rates in cells G56, G62, and G63.
  - Use 6.11% until further notice.

15. Revisit The EquityReturn Page

- Check the calculated CRP in D13 against the PAE Determined CRP in D14. Changes in transaction costs can change the result of the calculated CRP. Re-enter the CRP in D14 until equivalent to the result in D13.

16. Additional Optional Pages

- Rent Adjustments (Orig Form): this is the comparison grid from the suggested submission format. Many PAEs have found this a useful way of presenting the issues in making their market rent determinations.
- 92273-S8: this is the Rent Grid that appraisers are required to use under HUD Notice H-00-12.
- User Work and User Work 2: these are non-protected worksheets that users can utilize for any purpose, especially for providing explanation and documentation that cannot readily be incorporated elsewhere in the model. The intention is to enable users to record such information directly in the model, without having to go to a separate spreadsheet or Word document.
- 5.2 Form Data. This page pulls the data that will be needed for Form 5.2 on the OMHAR MIS system.

Addendum: The IRP&Recapture Page (Interest Reduction Payments; Rows 1 to 34):

- Row 11: Enter the total amount of IRP available each year for §236 deals. This should be entered as it appears in HUD's schedule of IRP payments for the given asset (see the HUD Amortization Schedule).
- Row 24: Enter the amount of IRP available for distribution each year.

- Generally, OMHAR recommends using the amount in I16 (Annual IRP Spread Evenly), for the number of years indicated in I15 (term of new 1st mortgage).
- Row 25: If any recaptured IRP is proposed for use to offset debt service on the new 1st mortgage, enter those amounts here.
- If your 1st mortgage is §223(a)(7) or is a loan modification of the §236 loan, use of IRP for debt service is acceptable. If you are using any other form of 1st mortgage financing, check with your Relationship Manager to see if OMHAR will approve use of IRP for debt service.
- Row 26: If any recaptured IRP is proposed for use to offset needed Reserve deposits, enter those amounts here.
- This approach is allowable for all forms of new 1st mortgage financing.
- Row 27: The model then calculates the remaining IRP amounts, to be recaptured by HUD for use in other Restructuring Plans. This may be overwritten.
- Row 28: The model then calculates any IRP remaining that is available for use in later years.
- Repeat as above for the Out-Year Recaptured Funds, if applicable. These entries occur in rows 40, 41, and 42. Excess Out-Year Recapture will return to HUD (row 43). NPV cells for the IRP Recaptured (G46) Recaptured Out-Year Funds (cell L46) have been included on this page as well. The discount rates are defaulted to 6.11% as found in Sources&Uses cell G56.

Addendum: The IRP&Recapture Page (HAP Recapture; Rows 35 to 51)):

- Row 40: Enter the difference between contract rents and post-M2M market rents, by year, for any out year HAP contracts that will stay in place after the M2M closing.
- Row 41: Generally, set row 41 equal to row 40. If your transaction needs to use recaptured HAP funds for Reserves, check with your Relationship Manager to determine whether OMHAR will approve that use.

Addendum: Sizing Exception Rents (ExcptRent Page):

- D9 and D11: Enter a market interest rate and MIP.
- D18-D20 (Rehab Loan rate, term, MIP) are pre-loaded to refer to the proposed first mortgage information on the Debt Service & Loan Sizing page.
- Ordinarily, cells C13 should be left at its initial value, for now.
- Cell D17 is the 1st mortgage amount to be used in your exception rent transaction. Generally, you should select the minimum amount that balances the Sources and Uses. One way to achieve this is to set this cell at zero, and then increase it until the out of balance indicator disappears.
- Cell D29 shows the trial Exception Rents, calculated as provided in the OPG.
- Enter the PAE's recommended exception rents in Cell D30, balancing the following:
  - Wherever possible, do not exceed 120% of FMR (D30 should be no more than D36).
  - DSCR (D40) of at least 1.20 on the new 1st mortgage.
  - Full IPF in year one (a warning will appear next to D46 if this requirement is not met).
  - 2nd and 3rd mortgages are sufficiently repayable to support a viable transaction (D41-D43). If the exception rents support a full 2nd mortgage amount (cell D41 is equal to or greater than cell D42), the owner is more likely to agree to restructure.
- Don't be alarmed at the DSCR (cell D40); this often will be quite high in exception rent transactions.
- Rows 69-73 contain vacancy, bad debt and management fee assumptions for use in exception rent projections. The model pre-loads these with the values from the Projected Income and Expense page, and you may modify them as necessary.